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IN THE

Supreme Court of the United States

October Term, 1951.
No. 237

A. BRIGHAM ROSE and ZELLETTA ROSE; LORI, LTD., INCORPORATED; ZELLETTA M. ROSE and A. BRIGHAM ROSE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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SUBJECT INDEX

PAGE

Opinions below 1

Jurisdiction 1

Questions presented 2

Statutes involved 3

Statement of the case 3

Specification of errors to be urged 5

Reasons for granting the writ 7

I.

The decision of the court below in upholding the Tax Court's inclusion of accounts receivable in connection with a determination of net income on a cash basis, is in conflict with the decisions of Courts of Appeals of other circuits and, also, with decisions of this court 7

II.

The failure of the court below to treat the said financial statements of petitioner Rose, correctly construed, as binding upon respondent is in conflict with general, long-established principles, recognized in a decision of the Court of Appeals for the Fifth Circuit 10

III.

The decision of the court below in upholding the decision of the Tax Court treating as income to Lori the income from certain property in respect to which Lori was a mere nominee or titleholder, the Tax Court having found that the beneficial owner was Rose, is in direct conflict with decisions of the Court of Appeals for the Eighth Circuit 12

IV.

The manner in which this proceeding was disposed of below poses a grave question of general importance in the administration of justice 15

Conclusion 16

TABLE OF AUTHORITIES CITED

Cases

	PAGE
Avery v. Commissioner, 292 U. S. 210	9
Burnet v. Logan, 283 U. S. 404	9
Central Life Assur. Society v. Commissioner, 51 F. 2d 939	14
Commissioner v. Phipps, 336 U. S. 410	8
Keokuk & Hamilton Bridge, Inc. v. Commissioner, 180 F. 2d 58	14
Kenney v. Commissioner, 111 F. 2d 374	11
National Bank of South Carolina v. Lucas, 36 F. 2d 1013	9
Snell Isle v. Commissioner, 90 F. 2d 481	11
Spring City Foundry v. Commissioner, 292 U. S. 182	8, 9
Weiss v. Wiener, 279 U. S. 333	8
United States v. Mitchell, 271 U. S. 9	9
William Hardy, Inc. v. Commissioner, 82 F. 2d 249	9

Statutes

Internal Revenue Code, Sec. 713	3
Internal Revenue Code, Sec. 1112	3
Internal Revenue Code, Sec. 1141(a)	1
Revenue Act of 1938, Sec. 22(a)	3
Revenue Act of 1938, Sec. 23(a)	3
Revenue Act of 1938, Sec. 41	3
Revenue Act of 1938, Sec. 42	3
Revenue Act of 1938, Sec. 43	3
Revenue Act of 1938, Sec. 293(b)	3
Tax Court Rule 50	2, 6
United States Code, Title 28, Sec. 1254(1)	1

Textbooks

20 American Jurisprudence, Sec. 915	11
32 Corpus Juris Secundum, Sec. 1040(d)	11
3 Jones on Evidence (4th Ed.), Sec. 236	11
1 National Tax Journal (No. 4, Dec., 1948), Seghers, Tax Accounting Compared With Recognized Accounting Principles	8
Reimer, Differences in Net Income for Accounting and Federal Income Taxes	8
4 Tax Law Review (No. 3, March, 1949), p. 343, Lasser and Peloubet, Tax Accounting v. Commercial Accounting	8

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vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on April 12, 1951.

Opinions Below.

The memorandum findings of fact and opinion of the Tax Court is reported in 8 TCM 8. The opinion of the Court of Appeals is reported in 188 F. (2d) 355.

Jurisdiction.

The judgment of the Court of Appeals was entered on April 12, 1951. [R. 575.] A petition for rehearing filed on May 5, 1951, was denied on May 17, 1951. [R. 576.] The jurisdiction of this Court is invoked under I. R. C., Section 1141(a), and 28 U. S. C., Section 1254(1).

Questions Presented.

1. Whether net worth and income figures shown by financial statements of a taxpayer, where such figures include large amounts of accounts receivable, can be applied in connection with determination of his net income on a cash basis without first eliminating the accounts receivable.

2. Whether such financial statements, correctly construed, are not binding on the government, where they were introduced into evidence by the government, over the taxpayer's objections on the grounds of incompetence and immateriality, and without any limitation on the purpose of their introduction.

3. Whether income from property in respect to which a corporation is a mere nominee or titleholder, an individual being the beneficial owner, is taxable to the corporation or to the individual.

4. Whether the individual in such case is taxable on the rental value of a part of such property occupied by him.

5. Whether in a computation of excess profits taxes under Tax Court Rule 50, effect may not be given to an "excess profits credit," mathematically determinable from the income figures found by the court, merely because such credit was not, as a separate item, claimed in the pleadings.

6. Whether a corporation is not entitled, in the computation of its income and excess profits taxes, to deduction for operating expenses of the corporation paid by an individual out of funds received by him from the corporation.

7. Whether any of the questions above is a question of fact or a question of law.

Statutes Involved.

Several statutory provisions are involved in the matters here considered, especially sections 22(a), 23(a), 41, 42, 43, and 293(b) of the Revenue Act of 1938 and the Internal Revenue Code, and also sections 713 and 1112 of the Internal Revenue Code. However, the questions raised here are not questions of construction of those provisions. For that reason, no statutory provisions are cited or quoted herein.

Statement of the Case.

For the sake of brevity and clarity, the facts specially pertaining to each ground for certiorari are stated under that ground. In order to avoid duplication, those facts are omitted here. As a result, this statement of the case contains only general facts and a skeleton of the case as a whole.

This proceeding involves income and excess profits taxes for the years 1938 to 1941, inclusive. Petitioners A. Brigham Rose and Zelletta Rose are husband and wife. [R. 428.] They came to California in 1927, at which time Rose was admitted to the bar. [R. 429.] Since that time he has engaged in the practice of law in Los Angeles. [R. 429.]

Petitioner Lori, Ltd., Incorporated is a California corporation organized in 1935. [R. 428.] Although it was authorized by its charter to engage in general business activities [R. 428], the record shows only that it held title to certain real estate, known as the "Villa-Courts" [R. 433], and that there was a bank account in its name. [R. 431.] During the period herein involved Rose was

president and treasurer of Lori, and owned two of its six issued shares. [R. 428.]

There were also three bank accounts in Rose's name. [R. 430.] The Commissioner recomputed Rose's net income on the basis of deposits in the accounts in his name, plus withdrawals from the Lori account. [R. 438-439.] He made allowances for certain expenses and certain non-income deposits. [R. 438-440.] The Tax Court adopted the Commissioner's method but made additional allowances for expenses and non-income deposits. [R. 440-441.] The Tax Court did the same in the case of Lori, on the basis of the deposits in the Lori account. [R. 445-447.]

At the trial, respondent introduced into evidence certain financial statements of Rose. [R. 89-91.] Those statements, however, included large and rapidly increasing amounts of accounts receivable, whereas Rose was on a cash basis. [~~Exh. S.~~; R. 428.] Including the accounts receivable, those statements support the Tax Court's determinations. [R. 577; ~~Exh. S.~~] Excluding the accounts receivable, however, they confirm the taxpayers' returns. [R. 526, 527, 506, 13, 529, 508; ~~Exh. S.~~]*

The Tax Court's findings set forth the totals shown in these statements without eliminating the accounts receivable. [R. 444; ~~Exh. S.~~] The Tax Court heavily relied upon these statements, especially in connection with the charge of fraud. [R. 450-451.]

Petitioners sought in the court below to hold that these statements, correctly construed and applied by eliminating the accounts receivable, were binding upon respondent.

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*A comparison of the figures is given *infra*, page 11.

At least, they sought to have the case remanded to the Tax Court so that the said statements, as so corrected, could be given proper weight. There was also the question whether, under the facts as found by the Tax Court, Lori was a mere nominee or titleholder, so that the income appearing in its name was taxable to Rose instead of Lori. Additional matters of lesser importance raised there are indicated herein in the questions presented, and specification of errors to be urged. The court below classified all of these matters as matters of fact, and decided simply that the Tax Court's findings were supported by the evidence. [R. 575.]

Specification of Errors to Be Urged.

The Court of Appeals erred:

1. In failing to hold that, Rose being on a cash basis, the net worth and income figures set forth in the Tax Court's findings, as derived from financial statements of Rose, must be corrected by excluding the amounts of accounts receivable and accounts payable reflected therein.

2. In failing to hold that the said figures, as so corrected, are binding upon respondent and must be given effect in the determination of the net income of Rose and his wife for the years involved.

3. In failing to remand the case to the Tax Court in order to enable that court to give proper weight to the said figures, as so corrected.

4. In failing to hold that the income from the Villa Courts was taxable to Rose, and not to Lori.

5. In failing to hold that Lori had no net income of its own at all.

6. In failing to hold that Rose was not taxable on the rental value of the part of the Villa Courts occupied by him.

7. In failing to remand the case to the Tax Court to enable that court to exclude from income large additional non-income deposits shown by the record.

8. In failing to hold that Rose was taxable on only his community one-half of his professional income for 1938.

9. In failing to hold that in the computation of excess profits taxes under Tax Court Rule 50, allowance should have been made for an excess profits credit, based upon the income of Lori as redetermined for the years 1938 and 1939.

10. In failing to hold that Lori was entitled to a deduction for the expenses of Lori paid by Rose out of funds received by him from Lori.

11. In failing to hold that the evidence was insufficient to sustain the Tax Court's finding of fraud.

12. In failing to hold that the basis of the stocks acquired by Rose as a fee and sold by him at a loss in 1941 was fair market value at the date of acquisition, and that the Tax Court should have made a determination of such value.

13. In failing to hold that the Tax Court should have determined some allowance for depreciation on the Villa Courts based on the mortgages to which said property was subject.

14. In affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT.

I.

The Decision of the Court Below in Upholding the Tax Court's Inclusion of Accounts Receivable in Connection With a Determination of Net Income on a Cash Basis, Is in Conflict With the Decisions of Courts of Appeals of Other Circuits and, Also, With Decisions of This Court.

The returns filed by Rose and his wife for the four years involved showed total net income for those years of approximately $38,000. [R. 526, 527, 506, 13, 529, 508.] The Commissioner, dissatisfied with those returns, as well as Rose's records, for each year added up the deposits in the bank accounts in Rose's name, plus certain items allegedly not deposited, and most of the withdrawals in the account in Lori's name, then made some deductions for expenses and clearly identified non-income deposits, and treated the result, aggregating approximately $117,000 for the four years, as the net income of Rose and his wife for those years. [R. 438-439, 526, 527, 506, 13, 509, 508.] In the Tax Court other expenses and non-income deposits, totaling about $37,000, were proved to the Court's satisfaction. [R. 440-441.] These the Court deducted from the Commissioner's totals, and in that manner redetermined the net income of Rose and his wife for the four years at an aggregate of approximately $80,000. [R. 577.]

By way of confirming the results so arrived at, and supporting a determination of fraud, the Tax Court set forth at length in its findings the totals of assets, net worth and annual income of Rose "during the period involved" [R. 451], as shown by statements of financial condition dated